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ALEXANDER L. STEVENS,
CLERK

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1983

TRIO MANUFACTURING COMPANY
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Certiorari To The United States Court
of Appeals For The Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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December 19, 1983

QUESTION PRESENTED

Whether tax accrual work papers prepared by an independent auditor are subject to administrative summons by the Internal Revenue Service without a showing of particularized need. This question is presently before the Court in United States v. Arthur Young Company, 677 F.2d 211 (2d Cir. 1982), cert. granted, ___ U.S. ___, 103 S.Ct. 1180 (1983).

INTERESTED PARTIES

The following persons may have an interest in the outcome of this case:

Trio Manufacturing Company

(Petitioner)

United States of America (Respondent)

George B. Pennington, CPA

Willis H. Newton and Lee M. Newton

Douglas P. McCallum, Special Agent,

Internal Revenue Service

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NO. _____

In The
Supreme Court of the United States
October Term, 1983

Trio Manufacturing Company,
Petitioner,
vs.
United States of America,
Respondent.

On Certiorari To
The United States Court of Appeals
For The Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

OPINION BELOW

The opinion of the Court of Appeals
is officially reported as In the Matter
of the Tax Liability of Willis H. Newton,

Lee M. Newton and Trio Manufacturing
Company; United States of America and
Douglas P. McCallum, Special Agent
Internal Revenue Service, v. George B.
Pennington, CPA, 718 F.2d 1015 (11th
Cir. 1983), and is reproduced as
Appendix A at pages A-1 through A-35.

JURISDICTION

The judgment of the Court of Appeals for the Eleventh Circuit was entered on November 3, 1983. (Appendix B, pages B-1 through B-2) A motion to stay the mandate of the Court of Appeals was granted on December 13, 1983, for the period to and including December 21, 1983. This petition for certiorari was filed within 90 days of the date of judgment and prior to the issuance of a mandate.

This Court's jurisdiction is
conferred under 28 U.S.C. § 1254.

STATUTE INVOLVED

Section 7602 of the Internal Revenue
Code of 1954, as amended, 26 U.S.C.

§ 7602, provides in relevant part:

Section 7602. Examination of books
and witnesses

(a) Authority to summon, etc. -
For the purposes of ascertaining the
correctness of any return, making a
return where none has been made,
determining the liability of any
person for any internal revenue tax
or the liability at law or in equity
of any transferee or fiduciary of
any person in respect of such inter-
nal revenue tax, or collecting such
liability, the Secretary or his

delegate is authorized -

(1) To examine any books,
papers, records, or other data
which may be relevant or material
to such inquiry;

. . .

(3) To take such testimony of
the person concerned, under oath,
as may be relevant or material to
such inquiry.

STATEMENT OF THE CASE

Petitioner is Trio Manufacturing Company, a Georgia corporation (herein called "Trio"). For the years 1977, 1978 and 1979, audited financial statements of the books of account of Trio were prepared in accordance with generally accepted auditing principles. These statements were provided to lenders and were otherwise used by Trio

in the course of business. Trio is not subject to the reporting requirements of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78l (herein called the "Exchange Act").

Respondent is the United States of America acting through the Internal Revenue Service (the "Service"). The Service is examining the federal income tax liability of Trio for the years 1977, 1978 and 1979.

As part of that examination, the Service, acting under the authority of 26 U.S.C. § 7602, issued an administrative summons to George B. Pennington, a certified public accountant. 718 F.2d at 1016-1017 (App. A-3 through A-5). For those years, Mr. Pennington conducted an examination of Trio's accounts and issued his report, which stated, with one minor exception not relevant

here, that the examination had been made in accordance with generally accepted auditing standards.

After issuance of the summons, Trio exercised its right under 26 U.S.C. § 7609 to stay compliance by Mr. Pennington until Trio's objections were litigated.

The United States petitioned the district court, under 26 U.S.C. §§ 7402(b) and 7604(a), to enforce inter alia the summons at issue.^{1/}

^{1/} A summons was also issued to Mr. Pennington to compel production of records relating to Willis H. and Lee M. Newton (the "Newton Summons"). For the purpose of the enforcement hearing, the actions to enforce the Newton Summons and the summons relating to Trio were consolidated. The district court ordered enforcement of the Newton Summons and the Eleventh Circuit denied

(Footnote Continued on Next Page)

The petition for enforcement was referred to a United States Magistrate to conduct a show cause hearing at which the government chose to rest on the allegations made in its petition for enforcement and the declaration of Special Agent McCallum, who had issued the summons. The government then tendered Agent McCallum and other government personnel involved in the case for cross-examination by Petitioner.

1/ (Footnote Continued from Previous Page)

a stay of the enforcement order. Mr. Pennington subsequently provided information that was called for by the Newton Summons and rendered an appeal of that enforcement order moot. However, the Newtons do not abandon their objections as regards the admissibility and use of the information obtained thereby in any subsequent proceedings.

(5-R. Vol. 10-11)^{1/} During the questioning of Agent McCallum, Trio "attempted to discover whether the Service sought tax accrual work papers by directly asking the agent who drafted the summons. The agent responded that he was unfamiliar with such documents." 718 F.2d at 1018 (App. A.-13)

The magistrate issued his report and recommendation that the summons in the matter of Trio's tax liability be enforced in its entirety. (3-R Vol. 294-300) The report of the magistrate was adopted without comment by the district court. (4-R Vol. 488)

^{1/} "R." references are to the five-volume record of the summons enforcement action. "Sup. R." references are to the three-volume record of the contempt action brought by the government against Mr. Pennington.

Trio then appealed to the Eleventh Circuit. The Eleventh Circuit granted a partial stay of the district court's enforcement order. The stay was limited to the tax accrual work papers.

Pennington then produced all of the summoned materials except those that Trio asserted fell within the Eleventh Circuit's stay. 718 F.2d at 1017 (App. A-9).

The tax accrual work papers withheld by Pennington were 21 pages which included work papers, notes, memoranda or other documents that were generated by Pennington in his role as auditor and used in verifying the accuracy of the financial statements of Trio for contingent tax liability, including the analysis and opinions of the auditor as to the strength, fairness, reasonableness and weakness of Trio's reporting

of transactions for federal income tax purposes. Those documents and testimony of the accountant relating to the documents and disclosures made by the client that were used in preparing these documents were withheld under authority of the stay granted by the Eleventh Circuit. (Supp. R. Vol. III-22)

The United States filed a motion in district court seeking to have Mr. Pennington held in contempt. After a hearing and in camera inspection of the 21 pages, the district court found the 21 pages to be tax accrual work papers and denied the government's application for contempt against Pennington. 718 F.2d at 1017 (App. A-9). An appeal was taken by the United States from the district court's denial of its contempt motion. The Eleventh Circuit

consolidated the appeals of Trio and the United States for purposes of consideration and disposition.

In its opinion, the Eleventh Circuit first rejected, as being "without merit", the government's argument that Trio had not adequately raised defenses as to production of tax accrual work papers. However, the Circuit Court held that it was not a defense to the summons that the government had failed to show particularized need for the tax accrual workpapers. In so holding, the Eleventh Circuit explicitly declined to follow and rejected the rationale and holding of the majority of the Second Circuit panel in United States v. Arthur Young Company, 677 F.2d 211 (2d Cir. 1982), cert. granted, ___ U.S. ___, 103 S.Ct. 1180 (1983), and "embrace[d] instead

the position taken by Judge Newman in dissent." 718 F.2d at 1021 (App. A-26).

The Eleventh Circuit stated that the issue of the Service's right of access to tax accrual work papers is to be resolved as follows:

Congress' explicit grant of summons power to the IRS should not be limited by a newly recognized privilege unless Congress itself chooses to so limit IRS authority.

718 F.2d at 1021 (App. A-28)

Given its holding that Congress, not the courts, should decide if the Service is required to show particularized need before obtaining tax accrual work papers, the Eleventh Circuit did not address the question of whether a showing of particularized need would be required only as to tax accrual work papers of large corporations, which are

subject to the reporting requirements of the Exchange Act.

The Eleventh Circuit also held that the government had met its required showing of relevancy under United States v. Powell, 379 U.S. 48 (1964), since "tax accrual work papers are relevant as a matter of law to a legitimate investigation of a corporation's correct tax liability." 718 F.2d at 1019 (App. A-17). On the basis of that holding, the court concluded that it was "unnecessary to discuss the further burdens of proof required in a summons enforcement proceeding." Id.

As to the government's appeal, the court found that in view of its prior partial stay of the summons enforcement order, the district court did not abuse its discretion in denying

the government's contempt motion against Pennington.^{1/}

On November 21, 1983, Trio filed a motion with the Eleventh Circuit requesting a stay of the mandate of that court pending Trio's petition to this Court for a writ of certiorari. On December 13, 1983, the Eleventh Circuit entered a conditional order staying the mandate. To continue the stay in effect until disposition of this case by the Court, the Eleventh Circuit required Trio to file, which it has done, a petition for certiorari no later than December 21, 1983.

^{1/} Trio does not seek to have the Court review this portion of the Eleventh Circuit's decision since the United States was without legal or factual basis to assert contempt sanctions against Mr. Pennington.

ARGUMENT

A. A CONFLICT EXISTS AMONG THE CIRCUITS AS TO WHETHER THE IRS MUST SHOW PARTICULARIZED NEED TO OBTAIN TAX ACCRUAL WORK PAPERS.

The holding of the Eleventh Circuit that the Service is not required to show particularized need to obtain tax accrual work papers is clearly in conflict with the decision of the Second Circuit in United States v. Arthur Young Company, 677 F.2d 211 (2nd Cir. 1982), cert. granted, __ U.S. __, 103 S.Ct. 1180 (1983).^{1/}

^{1/} In holding that tax accrual work papers are relevant to an Internal Revenue Service investigation as a matter of law, the decision of the Eleventh Circuit is also in conflict with the reasoning and holding of the Tenth Circuit in United States v. Coopers and Lybrand, 550 F.2d 615 (10th Cir. 1977).

The Court has granted a petition for certiorari and will review the Second Circuit's decision in Arthur Young. The legal and policy issues presented by this petition are the same as in Arthur Young.^{1/} As to Trio, the validity of the Eleventh Circuit's decision should be judged based on this Court's determination of whether the Service must show particularized need in order to obtain tax accrual work papers.

^{1/} The Fifth Circuit, in United States v. El Paso Company, 682 F.2d 530 (5th Cir. 1982), (petition for cert. pending), likewise rejected the Second Circuit's analysis in Arthur Young. However, the documents at issue in El Paso were not tax accrual workpapers prepared by an independent auditor.

B. THE ISSUE PRESENTED IN THIS CASE
HAS SIGNIFICANT EFFECT ON THE PUBLIC
INTEREST.

In order to protect the public interest and the integrity of the independent auditing process, the tax accrual work papers of independent auditors should be protected from routine access by the Service. The protection should be extended to all corporations publishing financial statements passed on by independent auditors.

The rationale of the Second Circuit in Arthur Young is initially founded on a concern that a conflict is created between the federal tax and securities laws. The securities laws demand a full disclosure of all material facts which may affect an investor's review of an entity's operation and assets. The

Second Circuit believed that an important aspect of this disclosure mechanism was audited financial statements and that the integrity of such financial statements might be harmed if the Service were allowed routine access to tax accrual workpapers.

The provision of the securities laws cited by the Second Circuit requires a company subject to SEC reporting under the Exchange Act to file financial statements. 15 U.S.C. § 781. The financial statements are to be accompanied by an independent accountant's report which states that the financial statements have been verified in accordance with generally accepted auditing standards. 17 C.F.R. § 210.2-02.(b), SEC Regulation S-X.

A company's liability for making reports under the Exchange Act is determined merely on the basis of the amount of its assets and the number of its shareholders.^{1/} Other securities laws mandate the use of audited financial statements as part of their scheme of disclosure to provide potential investors with information upon which to make an investment decision.

For example, Regulation D, as promulgated by the SEC, was issued for the explicit purpose of simplifying

^{1/} The Exchange Act requires, in general, that corporations engaged in interstate commerce which have more than 500 shareholders and total assets in excess of \$1,000,000 to file annual audited financial statements with the Securities and Exchange Commission. 15 U.S.C. § 781, section 12(g)(1) of the Exchange Act. By regulation, the SEC has exempted issuers that have total assets not exceeding \$3,000,000, 17 C.F.R. § 240.12g.1.

exemptions from registration under the Securities Act of 1933, 15 U.S.C. § 77a et seq., in order to facilitate capital formation for small businesses consistent with the protection of investors. Securities and Exchange Commission Release No. 33-6389

(April 15, 1982). For investors who are not deemed to be sufficiently able to absorb the economic risk of investment, entities that offer securities under Regulation D must provide audited financial statements to "non accredited" investors. 17 C.F.R. § 230.502(b)(2) (i). In offerings under Regulation D, the SEC does not review the sales material or financial statements which are given to potential investors. Nor are Regulation D offerings subject to the scrutiny of investment professionals

who regulate the national stock exchanges.

Accordingly, the "chilling effect" found to be potentially present if the Service was granted random access to tax accrual work papers also exists as to the business affairs of companies which are not subject to the reporting requirements of the Exchange Act. The public interest that is to be protected is the independent auditing process.

Additionally, the role and importance of audited financials is not, today, limited to communication with shareholders or potential investors. The financial statements of an entity are often required and relied upon in numerous commercial transactions. They constitute the means by which a corporation conveys information to its bankers, creditors or suppliers. The

integrity of a financial statement which states that it has been examined by an independent auditor and contains his conclusion that the statement is fair and accurate has developed a place in commercial transactions, which should not be disturbed or harmed, without compelling reasons.

If this Court in its Arthur Young decision determines that a showing of particularized need is required for the Service to obtain tax accrual work papers, such a requirement should not be limited merely to corporations who have reporting responsibility under the Exchange Act. It is the integrity of the independent auditing process as relied upon by investors, lenders, and those consummating commercial transactions that deserves consideration and preservation by this Court.

CONCLUSION

The decision below is clearly in conflict with the Second Circuit's opinion in Arthur Young, which is under review by this Court. Additionally, this case presents for the Court's consideration the public interest involved in preserving the integrity of the independent auditing process.

A writ of certiorari should, therefore, be granted to review, and ultimately reverse, the decision below in accordance with the Court's decision in Arthur Young.

Respectfully submitted,

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APPENDIX

APPENDIX A

In the Matter of The Tax Liability of
Willis H. NEWTON, Lee M. Newton and Trio
Manufacturing Company, Intervenor-
Appellants,

UNITED STATES of America, and Douglas P.
McCallum, special agent, Internal
Revenue Service, Plaintiffs-Appellees,

v.

George B. PENNINGTON, CPA,
Defendant.

UNITED STATES of America and Douglas P.
McCallum, Special Agent, IRS,
Plaintiffs-Appellants,

v.

George B. Pennington, CPA,
Defendant-Appellee.

Nos. 82-8586, 83-8056.

United States Court of Appeals,
Eleventh Circuit.

Nov. 3, 1983

Appeals from the United States
District Court for the Northern District
of Georgia.

Before JOHNSON and HENDERSON, Circuit
Judges, and ALLGOOD,* District Judge.

*Honorable Clarence W. Allgood, U.S.
District Judge for the Northern District
of Alabama, sitting by designation.

JOHNSON, Circuit Judge:

These consolidated appeals present the question whether tax accrual workpapers prepared by an independent auditor of a closely held corporation may be subject to summons by the Internal Revenue Service ("IRS") without special showing of particularized need for the material sought. We hold that tax accrual workpapers are subject to IRS summons without any special showing and, accordingly, we affirm the order enforcing the summons in this case. We also affirm the denial of the government's motion to hold respondent Pennington in contempt for his refusal to comply with that part of the district court order that this Court stayed pending appeal.

The facts of this case are undisputed. The IRS commenced an audit of the 1977-79 federal income tax

returns of the closely held Trio Manufacturing Company ("Trio" or "Taxpayer") and of Willis H. Newton, a major shareholder of the family-owned company, and his wife. During the course of its investigation, the IRS, acting under the authority of 26 U.S.C.A. § 7602,^{1/} issued two

^{1/} Section 7602 provides in relevant part:

§ 7602. Examination of books and witnesses (a) Authority to summon, etc.--For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized--

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(Footnote Continued on Next Page)

summonses to George B. Pennington, the certified public accountant retained by the Newtons to prepare their personal income tax returns and the corporate income tax returns of Trio, and to

1/ (Footnote Continued from Previous Page)

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned under oath, as may be relevant or material to such inquiry.

26 U.S.C.A. § 7602.

conduct audits of Trio for the years 1977, 1978 and 1979.^{2/} The summons here in dispute sought information regarding Trio's tax liability, including any and all workpapers, analyses and computations prepared in the course of Pennington's annual audits of Trio.

In accordance with Taxpayer's directions, Pennington refused to comply with the summons, and the IRS petitioned the district court for an order enforcing its summons.^{3/} Pennington

^{2/} The preparation of audited financial statements by a certified public accountant was required by banks from whom Trio obtained credit.

^{3/} The IRS enforcement action was premised on § 7604(b) of the Internal Revenue Code.

(b) Enforcement.--Whenever any person summoned under section 6420(e)(2), 6421(f)(2), 6427(h)(2), or 7602 neglects or refuses to obey

(Footnote Continued on Next Page)

informed the court that he would comply with any order that it might enter and

1/ (Footnote Continued from Previous Page)

such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

26 U.S.C.A. § 7604(b).

The jurisdiction of the district court was premised on §§ 7402(b) and 7604(a) of the Code.

(Footnote Continued on Next Page)

that his refusal to produce the summoned documents was only in deference to Taxpayer's directions. Taxpayer

1/ (Footnote Continued from Previous Page)

§ 7402. (b) To enforce summons.--If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides or may be found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

26 U.S.C.A. § 7402(b).

§ 7604. Enforcement of summons

(a) Jurisdiction of district court.--If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records or other data.

26 U.S.C.A. § 7604(a).

successfully moved to intervene in the enforcement action.^{1/}

The district court referred the case to a magistrate. After an evidentiary hearing and briefing by the parties, the magistrate recommended that the summons be enforced in its entirety. The district court adopted the magistrate's report and recommendation.

Taxpayer appealed, and this Court, after initially denying Taxpayer's motion for a stay of the enforcement order, granted a partial stay of the order with respect to the tax accrual workpapers sought by the IRS.

^{1/} Section 7609(b) of the Internal Revenue Code permits intervention in a third-party summons proceeding by the real party in interest. 26 U.S.C.A. § 7609(b).

Pennington then produced all of the summoned materials except those that the Taxpayer asserted fell within this Court's stay, which after negotiations included some twenty-one pages of documents.

The government, disputing that tax accrual workpapers are beyond the scope of IRS summons authority and disputing that the documents withheld even constitute tax accrual workpapers, filed a motion in district court seeking to have Pennington held in contempt. The district court, considering this Court's partial stay, conducted an in camera review of the disputed documents, determined that they were tax accrual workpapers and denied the government's contempt motion.

Trio appeals the district court's order enforcing the IRS summons as to

tax accrual workpapers. The government appeals the district court's denial of its contempt motion. We will consider these consolidated appeals in turn.

I. TAXPAYER'S APPEAL.

Trio argues that this Circuit should follow the decision of the Second Circuit in United States v. Arthur Young & Company, 677 F.2d 211 (2d Cir.1982), cert. granted, _____ U.S. _____, 103 S.Ct. 1180, 75 L.Ed.2d 429 (1983), and hold that an accountant work product privilege protects tax accrual workpapers from IRS summons power absent a showing of particularized need and inability to obtain the substantial equivalent from other sources. Trio further argues that no such showing has been made here.

Trio also argues that the district court erred as a matter of law in concluding that Pennington's tax accrual workpapers are relevant to the amount of Taxpayer's federal income tax liability. Trio argues that tax accrual workpapers are not relevant per se to an IRS investigation of Taxpayer's correct tax liability. Trio further argues that the relevancy of the documents to the IRS investigation cannot be determined simply from the description of the documents in the IRS summons, but that the Service must make a further showing of relevancy after the Taxpayer presents some contrary evidence. Trio contends that the IRS failed to make this showing.

Preliminarily, we must address the government's contention that the question whether tax accrual workpapers are protected from IRS summons power is

not properly before this Court because it was not adequately raised below. This contention is without merit. As we have recently noted, "[t]he law is clear that, absent special circumstances, defenses not presented and for which proof is not offered in the trial court cannot be raised for the first time on appeal." Johnson v. Smith, 696 F.2d 1334, 1338 (11th Cir.1983). The record in this case clearly indicates that Trio raised the tax accrual issue in the district court, even if it did not concentrate on that issue in its defense. Moreover, it appears that the reason Taxpayer did not emphasize the issue is that the government never specified that it was seeking "tax accrual" documents.

The broad language of the summons sought any and all workpapers, analyses and computations prepared in the course

of Pennington's audits of Trio.

Taxpayer sought to clarify the scope of the summons through subpoenas of IRS agents and documents and supported its position with the argument that the government must make a showing of particularized need for workpapers and analyses prepared during a financial audit. The government successfully moved to quash Taxpayer's subpoenas. At the evidentiary hearing, Taxpayer attempted to discover whether the Service sought tax accrual workpapers by directly asking the agent who drafted the summons. The agent responded that he was unfamiliar with such documents. Finally, in the Taxpayer's proposed findings of fact and conclusions of law submitted to the magistrate and in its objections to the magistrate's report, Taxpayer cited Arthur Young and argued

that tax accrual workpapers could not be subject to IRS summons merely on a showing of their relevancy to a tax investigation. In view of these facts, we hold that Taxpayer adequately presented this defense to the trial court, and this Court may consider the issue on appeal.

A. Whether tax accrual workpapers are relevant.

The Internal Revenue Service has broad authority under Section 7602. The Service may examine "any books, papers, records or other data which may be relevant or material" to its investigation of the correctness of any tax return. 26 U.S.C.A. § 7602(a). The Supreme Court in United States v. Powell, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964), defined the minimal showing that the IRS must make when

seeking an order to enforce its
summons. Id. at 57-58, 85 S.Ct. at
255. It must show that

the investigation will be conducted
pursuant to a legitimate purpose,
that the inquiry may be relevant to
that purpose, that the information
sought is not already within the
Commissioner's possession, and that
the administrative steps required
by the Code have been followed . . .

Id.

The Service can satisfy its burden
merely by presenting the sworn affidavit
of the agent who issued the summons.

United States v. Southeast First

National Bank of Miami Springs, 655 F.2d
661, 664 (5th Cir.1981).^{5/} Once the

^{5/} The Eleventh Circuit Court of
Appeals has adopted the case law of the
former Fifth Circuit handed down as of
September 30, 1981, as its governing
body of precedent, which is binding
unless and until overruled or modified
by this Court en banc. Bonner v. City
of Prichard, 661 F.2d 1206, 1209 (11th
Cir.1981) (en banc.).

government makes this minimal showing, the burden shifts to the taxpayer to disprove one of the elements of the government's case or to show that enforcement of the summons would be an abuse of the court's process. Id.; United States v. Davis, 636 F.2d 1028, 1034 (5th Cir.1981).

Taxpayer here argues that the Service carries the ultimate burden in a summons enforcement proceeding. If the taxpayer presents some evidence that the government has not satisfied the Powell requirements or that enforcement otherwise would be an abuse of process, then the government must come forward with ultimately persuasive evidence. Trio argues that, after it presented evidence challenging the relevancy of the tax accrual workpapers to the IRS tax investigation, the government was

required to persuade the court that the workpapers were relevant to its investigation.

Because we determine that the IRS here made the minimal showing as required by Powell and that tax accrual workpapers are relevant as a matter of law to a legitimate investigation of a corporation's correct tax liability, we find it unnecessary to discuss further the burdens of proof required in a summons enforcement proceeding.

Due to the complexity of the federal tax structure, the return filed by a corporate taxpayer often is not the final statement of the amount of taxes owed. Taxpayers often are required to pay more in taxes than their returns indicated. Many corporation, therefore, set aside a reserve on their balance sheets to cover this potential additional

liability. Corporate financial statements that do not include a reserve for contingent tax liability may give an inaccurate picture of the firm's financial position. Consequently, as Trio itself noted, generally accepted auditing principles require auditors to assess a corporation's contingent tax liability and determine whether it is great enough to require the corporation to reveal the potential liability on its balance sheet. In addition, federal securities laws require regulated corporations to file with the Securities and Exchange Commission financial statements that have been audited by independent accountants in accordance with generally accepted auditing principles.^{5/} The documents generated

^{5/} 15 U.S.C.A. § 781; 17 C.F.R. § 210.1-02(d).

by that tax accrual analysis disclose the weak spots in the corporation's assessment of its own tax liability.

In United States v. Wyatt, 637 F.2d 293 (5th Cir.1981), the former Fifth Circuit, in a decision that is binding on this Court, articulated the test for relevancy under Powell. The test is "whether the summons seeks information which 'might throw light upon the correctness of the taxpayer's return'" and, more narrowly, whether there is "an indication of a 'realistic expectation rather than an idle hope that something might be discovered.'" Id. at 300-01 (citations omitted).

The Fifth Circuit, applying this test in a nonbinding decision, recently held that tax accrual workpapers are relevant to a determination of a

corporation's tax liability. United States v. El Paso Company, 682 F.2d 530, 537 (5th Cir.1982). The court there rejected the suggestion that tax accrual workpapers are not relevant because they are neither tools used to prepare tax returns nor source documents representative of actual transactions. Id. The court thus squarely rejected the reasoning of United States v. Coopers & Lybrand, 550 F.2d 615 (10th Cir.1977), which denied the relevancy of tax accrual workpapers to an IRS investigation. Id. at 621.

Applying the Wyatt definition, we agree that tax accrual workpapers are relevant. The workpapers highlight and assess questionable tax interpretations that the taxpayer has given to its transactions. As the Arthur Young court itself noted in holding tax accrual

workpapers relevant to a legitimate IRS investigation, "[d]ifferent tax positions lead to different amounts of liability. It is difficult to say that the assessment by the independent auditor of the correctness of the positions taken by the taxpayer in his return would not throw 'light upon' the the correctness of the return." 677 F.2d 211, 219 (2d Cir.1982), cert. granted, ____ U.S. ____, 103 S.Ct. 1180, 75 L.Ed.2d 429 (1983).^{2/} Moreover, the controlling precedent of this Circuit does not require that information relevant to a tax

^{2/} The Second Circuit, while holding that tax accrual workpapers are relevant to a legitimate IRS investigation, also held that they are protected from IRS summons by an accountant work product privilege that can be overcome only upon a showing of a particularized need. 677 F.2d at 220-21.

investigation be limited to source documents or materials used in preparing returns. See, e.g., United States v. Wyatt, 637 F.2d 293 (5th Cir.1981) (summons sought corporate officials' answers to specific questions regarding their knowledge of bribes, kickbacks and other illegal transactions); United States v. Newman, 441 F.2d 165 (5th Cir.1971) (summons sought records of taxpayer's business associates). We thus join the Second and Fifth Circuits in rejecting the Tenth Circuit's holding in Coopers & Lybrand.

B. Whether tax accrual workpapers are privileged.

Taxpayer argues that, even if relevant, tax accrual workpapers should not be subject to IRS summons authority absent a showing of particularized need. Taxpayer asks this Court to adopt

and extend the reasoning of the Second Circuit in United States v. Arthur Young Company, 677 F.2d 211 (2d Cir.1982), cert. granted, _____ U.S. _____, 103 S.Ct. 1180, 75 L.Ed.2d 429 (1983), which held that tax accrual workpapers prepared by independent auditors of a public corporation subject to the federal securities laws are protected from IRS summons authority by a work product privilege similar to the attorney work product privilege recognized by the Supreme Court in Hickman v. Taylor, 329 U.S. 495, 67 S.Ct. 385, 91 L.Ed. 451 (1947), and embodied in Rule 26 of the Federal Rules of Civil Procedure.

The decision of the Second Circuit in Arthur Young is based on a perceived conflict between the federal tax and securities laws. The court observed

that a decision to permit the IRS routinely to summon documents that contain an auditor's assessment of the questionable tax position taken by its client would undermine the integrity of the auditing process and defeat the purpose of the securities laws mandating independent financial audits and public filing of financial statements. 677

F.2d at 219-20. The court assumed that corporate officials would be less forthcoming with an independent auditor once they knew that the auditor's assessment of the corporation's contingent tax liability would be readily accessible to Internal Revenue agents. Id. at 220. Faced with this "clash between two important congressional policies," id., and cognizant of the Supreme Court's recognition that "'contrary legislative

purposes' can undercut the 'broad latitude' otherwise provided to the IRS," id. at 219 (quoting United States v. Euge, 444 U.S. 707, 716 & n. 9, 100 S.Ct. 874, 880 & n. 9, 63 L.Ed.2d 141 (1980)), the Second Circuit carved out of the IRS summons authority a new accountant work product privilege. The court stated that the new privilege, similar to the attorney work product privilege, allows "the IRS to procure [tax accrual workpapers] when the rare situation arises when it can make a sufficient showing of need to adequately justify invading the integrity of the auditing process." Id. at 221.

Trio argues that this Court should adopt the reasoning of Arthur Young and extend it to a case that does not present the same conflict between congressional purposes--because it

involves a closely held corporation that is not subject to the federal securities laws--but that does implicate similar policy concerns. We decline this invitation to follow the Second Circuit and embrace instead the position taken by Judge Newman in dissent. We also note the Fifth Circuit's recent decision in United States v. El Paso Company, 682 F.2d 530 (5th Cir.1982), which supports our decision in this case.

The broad summons authority that Congress gave to the Internal Revenue Service under Section 7602 is subject to the "'traditional privileges and limitations.'" Upjohn Company v. United States, 449 U.S. 383, 398, 101 S.Ct. 677, 687, 66 L.Ed.2d 584 (1981). The Supreme Court has held, for example, that the attorney-client privilege and the attorney work product doctrine limit

the scope of the IRS summons power. Id.
at 386, 101 S.Ct. at 681. Federal law,
however, does not recognize an
accountant-client privilege, Couch v.
United States, 409 U.S. 322, 335, 93
S.Ct. 611, 619, 34 L.Ed.2d 548 (1973);
International Horizons, Inc. v.
Committee of Unsecured Creditors, 689
F.2d 996, 1003-04 (11th Cir.1982), or,
at least before Arthur Young itself, an
accountant work product privilege,
United States v. Arthur Young Company,
677 F.2d at 222 (Newman, J.,
dissenting).^{1/}

^{1/} Despite extensive and recent
precedent explicitly rejecting the
existence of an accountant-client
privilege under federal common law, the
Second Circuit's decision essentially
creates just such a privilege. Although
the court labels its creation an
accountant work product privilege, the
policy rationale it relied upon to
support its new doctrine--encouraging

(Footnote Continued on Next Page)

Congress' explicit grant of summons power to the IRS should not be limited by a newly recognized privilege unless Congress itself chooses to so limit IRS authority. The Supreme Court in its review of IRS summons power has made clear that "absent unambiguous directions from Congress," the courts should not impose additional restrictions on the scope of Section 7602. United States v. Bisceglia, 420

1/ (Footnote Continued from Previous Page)

corporate officials to reveal openly to their independent accountants the corporation's tax vulnerabilities--argues for an accountant-client communications privilege to be exercised by the client rather than an accountant work product doctrine to protect the accountant's independent assessment of the amount of tax that the corporation owes to the federal fisc. See United States v. El Paso Company, 682 F.2d 530, 541 n. 13 (5th Cir.1982); Arthur Young, 677 F.2d at 223, n. 5 (Newman, J., dissenting).

U.S. 141, 150, 95 S.Ct. 915, 921, 43
L.Ed.2d 88 (1975).

Trio is not subject to the same federal securities laws that were deemed critical to the decision in Arthur Young, but it argues that the same policy there embraced--protection of accountant work product to ensure the integrity of the auditing process and the protection of investor confidence--should be adopted here. In view of our determination that Congress is the proper body to make any decision to limit IRS summons power with newly recognized privileges, and especially in the absence of any conflicting congressional purposes, we refuse to adopt the position urged upon us by the Taxpayer.

II. GOVERNMENT'S APPEAL.

The government appeals the district court's denial of its motion to hold Pennington in contempt for his failure to produce twenty-one documents within the scope of the court's summons enforcement order. The government notes that use of the contempt motion was procedurally necessary to bring before this Court the tax accrual workpapers issue, but concedes that imposition of sanctions to obtain those records may be unnecessary. We agree.

This Court granted a stay of the district court's summons enforcement order with respect to tax accrual workpapers within the doctrine of Arthur Young. In granting the partial stay, we noted that, if the parties could not agree on what was required to be produced under the IRS summons, their

dispute could be adjudicated by the district court in a contempt proceeding. Throughout the entire course of this litigation, respondent Pennington has repeatedly made clear his willingness to comply with any court order, including any order issuing from the contempt proceeding.

The standard of review on appeal from a grant or denial of a civil contempt motion is whether the district court abused its discretion.

Washington-Baltimore Newspaper Guild, Local 35 v. Washington Post Co., 626 F.2d 1029, 1031 (D.C.Cir.1980); cf. United States v. Brummitt, 665 F.2d 521, 526 (5th Cir.1981), cert. denied, 456 U.S. 977, 102 S.Ct. 2244, 72 L.Ed.2d 852 (1982) (criminal contempt). The standard requires the petitioner in a civil contempt case to prove by clear

and convincing evidence that the respondent violated the court's prior order. 626 F.2d at 1031; see Northside Realty Associates, Inc. v. United States, 605 F.2d 1348, 1352 (5th Cir. 1979).

The government argued before the district court, and it repeats its argument here, that no tax accrual workpapers within the doctrine of Arthur Young exist in this case because Trio is a closely held corporation and because its balance sheet does not contain a reserve for contingent tax liability. In its November 19, 1982, memorandum decision denying the contempt motion, the district court noted that Arthur Young may not apply to this case, but on the basis of this Court's partial stay correctly decided to assume applicability of the doctrine until this Court could decide the question.

The government also argued that the district court did not have a sufficient factual basis for determining that the documents withheld from the IRS were tax accrual workpapers. The government first points out that Pennington himself did not testify that the documents withheld were tax accrual workpapers or even that his audit of Trio included an analysis of its contingent tax liability. The government then simply argues that in camera inspection of the documents cannot reveal whether they reflect such analysis.

Pennington's failure to testify is not probative on the question whether the documents withheld were tax accrual workpapers because Pennington throughout the course of these proceedings has sought to maintain his neutrality. Furthermore, the court had before it

evidence that Pennington's financial audit reports were prepared in accordance with generally accepted auditing principles, which require the auditor to review with management the question whether any contingent liabilities exist. Finally, under the circumstances of this case, in camera inspection of the disputed documents seems to be the only feasible means of determining whether the documents are tax accrual workpapers without revealing to the IRS the contents of the materials sought to be protected.

In view of this Court's partial stay of the summons enforcement order, the district court did not abuse its discretion in denying the government's contempt motion.

Accordingly, we AFFIRM the order enforcing the IRS summons, and we AFFIRM the denial of the government's contempt motion.

APPENDIX B

UNITED STATES COURT OF APPEALS
For The Eleventh Circuit

No. 82-8586
83-8056

D.C. Docket No. C82-1138A & C82-1139A

In the Matter of the Tax Liability of
Willis H. NEWTON, Lee M. Newton and
Trio Manufacturing Company, Interv-
venors-Appellants,

UNITED STATES of America, and Douglas
P. McCallum, special agent, Internal
Revenue Service, Plaintiffs-Appellees,

v.

George B. PENNINGTON, CPA,
Defendant.

UNITED STATES of America and Douglas
P. McCallum, Special Agent, IRS,
Plaintiffs-Appellants,

v.

George B. PENNINGTON, CPA,
Defendant-Appellee.

Appeals from the United States
District Court for the Northern District
of Georgia.

Before JOHNSON and HENDERSON,
Circuit Judges, and ALLGOOD*, District
Judge.

J U D G M E N T

This cause came on to be heard on the transcript of the record from the United States District court for the Northern District of Georgia, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the District Court appealed from, in this cause be, and the same is hereby, AFFIRMED;

It is further ordered that each party bear their own costs on appeal to be taxed by the Clerk of this Court.

November 3, 1983

*Honorable Clarence W. Allgood, U.S. District Judge for the Northern District of Alabama, sitting by designation.

ISSUED AS MANDATE: